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SUBJECT: VIETNAM ISSUES TEXTILE QUOTA ALLOCATION GUIDELINES

REF: HCMC 297

1. (SBU) SUMMARY: The GVN has announced quota allocation criteria for textile and garment exports to the U.S. Sixty-five to seventy percent of quota will be allocated based on past performance over the period of calendar year 2002 and the first quarter of 2003. The remainder will be issued to new companies and firms meeting a range of other criteria. AMCHAM and others had lobbied strongly for quota to go first to past performance. The allocation of the performance-based quota should be a relatively transparent process, but criteria for the remainder has yet to be clarified. Many buyers and producers worry that this could allow quota to be steered to politically connected firms. The biggest problem, however, is that contrary to the circular itself, which calls for 80% of performance quota to be allocated by the end of May, no such allocation has yet occurred. Producers and buyers are becoming increasingly nervous that as all companies, whether eligible for performance-based quota or not, continue to ship, available quota shrinks every day. Producers still argue, however, that quota is still a competitive advantage over China. End Summary.

Quota Criteria allocates 65-70% to Past Performance

2. (U) In a joint circular issued by the Ministries of Trade, Planning and Investment, and Industry, the GVN spelled out guidance for quota allocation for export of textile and apparel to the U.S. market. The circular, dated May 27 and released a few days later, covers quota allocation for the period from May 1 to December 31, 2003.

3. (U) Depending on quota category, 65-70% of available quota will be allocated based on past performance, with past performance defined as shipments to the U.S. market during calendar year 2002 and the first quarter of 2003. Most of the remaining quota (from 23-28%, again depending on category) will be allocated according to a variety of criteria:

--To enterprises with high production and export capacity, but which just began to export in late 2002 or early this year.

--To enterprises which have no "past performance" record of export, but which now have export contracts which can be filled with current capacity. "Priority [will be] given to enterprises that have invested in modern equipment and technology to produce textile and apparel products of high quality for export."

--Three percent in this category will be reserved for companies that have signed contracts directly with U.S. importers and distributors.

Ministry of Trade officials explained that they decided to establish a range on quota distribution to allow them the flexibility to fine tune the system as they are implementing it.

4. (U) The remaining 7 percent of quota will be reserved for enterprises using "significant" amounts of materials and fabrics made in Vietnam or for enterprises located in "economically difficult areas" which have production capacity and export contracts.

Schedule is Already Slipping

5. (U) The circular directs that the quota be allocated according to a schedule that has already slipped. Eighty percent of performance-based quota for companies that had already properly documented past performance was to have been issued by the end of May. This has yet to occur. Eighty percent of performance-based quota for other companies and quota based on the other criteria is to be issued by the end of June. According to Ministry of Trade officials, they plan to

allocate the remaining 20% of the quota once the Visa Certification system is in place.

16. (SBU) The circular prohibits quota from being transferred or sold between companies and notes that companies that do not utilize all their quota must surrender the excess quota in writing by October 1 to qualify for the same quota level next year. Visas will be required for shipments after July 1. NOTE: Privately, MOT officials has expressed their concern about the task of administering the quota system, especially in light of the minimal prep time they have had to get it up and running. We're not surprised that they are running behind schedule but believe that they are making a sincere effort in the face of intense pressure and outside scrutiny.

The Devil is in the Details

17. (SBU) Several foreign buyers and producers have told econoff that they believe the performance-based quota will be allocated in a relatively fair and transparent manner, but they are much more pessimistic about the allocation of the quota based on the other criteria. Rumors have already started to circulate that one Jaguar-driving son of the key MOT official responsible for quota is an avenue for obtaining quota. Although the circular states that allocation shall be "carried out in a transparent, reasonable manner" the devil is in the details and evidently buyers and producers here believe in the devil. For all of the efforts at transparency - the circular as well as export data for the month of May appears on the Ministry of Trade website, and the ministries involved solicited comments from buyers and producers - it is far from clear how the non-performance quota will be allocated. Although Ministry of Trade officials verbally explained to us their intended process and assured us of their intent to be as transparent and as fair as possible, the published criteria are vague and could create a situation where decisions are made on a case-by-case basis, allowing for outside pressure to be brought to bear on MOT. And even though quota is not to be sold or transferred, some producers have told econoff that they are already looking for quota from companies that might have a surplus.

18. (SBU) For example, 7% of the quota is reserved for companies using local materials or located in "economically difficult areas," but the circular did not define "economically difficult areas," nor did it specify local content criteria. (Note: We assume that MOT will use the GVN's list of economically depressed or underdeveloped regions as established by the Ministry of Planning and Investment under its poverty alleviation program.) MOT has assured us they are working on the criteria and procedures to evaluate the applications of new enterprises seeking quota or those that just began shipping at the end of last year, but was unable to provide details or a firm implementation date. One sweater manufacturer which has invested \$5 million in a plant in Ho Chi Minh City told econoff that although his company had been registered here for about two years, exports to the U.S. have so far been relatively small, because of the time it took to get the factory up and running and to hire and train his staff. The criteria as issued do not give him any hint of whether or how he will get quota.

Picking Favorites

19. (SBU) Buyers, producers and even Vietnamese officials point out that this lack of clarity will help connected firms get the quota they need to export. Some of the criteria seem designed to benefit state-owned enterprises (SOEs) - such as the criteria which base some allocation on "capacity of production and export". The guidance measures capacity in part as number of workers, machinery, etc, which SOEs have in abundance. AMCHAM, by contrast, had suggested that any additional quota be based on paid-in capital, which would have favored foreign-invested firms (Reftel). SOEs are also more likely to locate in those economically difficult areas which will receive additional quota.

110. (SBU) All business sector interlocutors stressed, however, that the lack of clarity in assigning the non-performance quota would not simply benefit SOEs, but would benefit firms with strong political connections or those seeking to make them. Many producers stressed that some large private Vietnamese firms were very well connected and would have little problem obtaining the quota that they needed. One Vietnamese private sector factory owner close to high-level officials told econoff weeks before this guidance was released he had absolutely no concerns about obtaining the quota that he needed.

111. (U) Small private firms were likely to do less well however. Many of these firms have limited "past performance" and even fewer political connections. One Hong Kong producer noted that many of these private firms worked as subcontractors for larger firms when producing for the U.S. market. In such cases performance quota would accrue to the consignor, not to the subcontractor.

112. (SBU) According to one Vietnamese official, Korean firms also influenced the design of the allocation process. A large group of foreign buyers and producers had been recommending through a joint AMCHAM committee that companies with past performance receive quota which at least matched past performance. Koreans, many of whom recently opened factories and had little or no past performance argued for limiting quota based on past performance to allow for quota allocations to new firms. According to this official, representations were made by the Korean Ambassador to Trade Minister Tuyen, and the Prime Minister of Korea made the same appeal in writing to the highest levels of the GVN. Evidently, it worked. However, we should note that several U.S. firms expressed exactly the same concern to us and are very pleased that MOT included provisions for new firms.

Quota Disappearing by the Day -----

113. (U) A larger worry among foreign buyers and producers is the timing of the actual quota allocations, which have yet to occur. MOT officials told us in late May that they intended to allocate quota by the end of May for those firms that had met the May 15 deadline for applications. The circular in fact states that 80% of the performance quota will be allocated "by the end of May." As of June 5, this had yet to occur, although firm hear that the allocation is coming "any day." Quota covers the eight-month period from May 1 to the end of the year. Without quota allocations, product continues to be shipped madly to the U.S. Producers are worried that when quota is finally allocated, much of it will have already been used up - and with good reason. According to the Ministry of Trade website (www.mot.gov.vn), as of June 3, nine of the 22 categories have already shipped over 25% of the available quota for the rest of the year. (Note: because the textile agreement took effect on May 1 this year, only two-thirds of the total annual quota is available in each category for the period May 1 - December 31, 2003.) In the two largest categories 338/339 22% of the available quota has already been shipped and category 347/348 has already shipped 30% of the available quota.

114. (SBU) Comment: Even though the MOT circular instructions lacked adequate detail (not uncommon), and despite the delay in quota allocation, buyers and producers are still bullish on Vietnam. They are pleased the circular calls for a sizable portion of quota to be allocated based on past performance. Vietnam's competitive advantage is still quota, one producer told econoff. He estimated that production costs are still 15% higher than China and operating costs are 20% higher, but quota is still cheaper than in China. With most of it free here for past producers, he would somehow acquire the rest of what he needed from the allocation process or, although technically illegal, by buying surplus from other producers. The biggest problem now is getting quota allocations issued before even more available quota is used up.

YAMAUCHI